

**TREASURY - GENERAL**

**STATE INVESTMENT COUNCIL  
Common Pension Fund E**

**Proposed New Rules: N.J.A.C. 17:16-69**

Authorized By: State Investment Council, Peter A. Langerman, Director,  
Division of Investment

Authority: N.J.S.A. 52:18A-91

Calendar Reference: See Summary below for explanation of exception to calendar  
requirement.

Proposal Number: PRN 2005-68

Submit comments by April 23, 2005 to:

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The agency proposal follows:

Summary

The proposed new rules provide for establishment of a new common fund in which five New Jersey pension funds' (Police and Firemen's Retirement System; Public Employees' Retirement System; State Police Retirement System; Teachers' Pension and Annuity Fund; and Judicial Retirement System of New Jersey) commingled alternative investment assets will be held. Said fund shall be known as Common Pension Fund E. Diversification of the pension fund assets into alternative investments is intended to enhance the pension funds' returns.

For any of the pension and annuity group funds investing in Common Pension Fund E, not more than 13 percent of the market value of any pension fund's assets, as authorized under proposed rules N.J.A.C. 17:16-71, 90 and 100, published elsewhere in

this issue of the New Jersey Register, may be invested in alternative investments. If the investments exceed the 13 percent market value limit, the Division shall notify the Council at a regularly scheduled meeting. The Council may grant the Division a six-month grace period during which to reduce the level of investments and may extend that for additional four-month periods. After the Director has made binding commitments aggregating an amount of \$2 billion, not more than five percent of the market value of Common Pension Fund E may be committed to any one partnership or investment, without the prior written approval of the State Investment Council. Common Pension Fund E shall not own more than 25 percent of any individual investment, and investments in Common Pension Fund E cannot comprise more than 20 percent of any one investment manager's total assets.

The Director of the Division of Investment shall provide the Council's Investment Committee with the requested due diligence information for all investments recommended by the Division, and in all cases, these materials shall include, but not be limited to, information demonstrating that the investment satisfies the limitations and conditions contained in the rules of the State Investment Council (N.J.A.C. 17:16-71, 90 and 100), and a written disclosure submitted by the asset manager summarizing any and all compensation arrangements with consultants and intermediaries, whether direct or indirect, in connection with the proposed investment. On investments of \$50 million or more, prior to any binding commitment, the Investment Committee shall provide a report to the State Investment Council, which report shall include a written due diligence report by the Director. On a timely basis after receipt of such report, the State Investment Council may adopt or otherwise act upon the report. On investments of \$50 million or less, the Director shall provide an informational due diligence report to the State Investment Council of every investment made, which shall be provided on a regular basis subsequent to the date such investment has been made. At any time during any given calendar year, at least 80 percent of the number of investments which are approved and 80 percent of the dollar amount of total investment commitments must be eligible for a report by the Investment Committee to the State Investment Council. For investments under \$50 million, so long as such investments constitute no more than 20 percent of the number of investments approved and 20 percent of the total investment dollars

committed, the Investment Committee will not issue a report to the State Investment Council. Once the 20 percent “exemption” in any given year has been exceeded, all proposed investments will be subject to the Investment Committee providing a report to the State Investment Council until the number and dollar value of “exempt” investment again falls below the 20 percent threshold.

Because the Division is providing a 60-day comment period on this notice of proposal, this notice is exempt from the rulemaking calendar requirement pursuant to N.J.A.C. 1:30-3.3(a)5.

#### Social Impact

While the proposed new rules broaden the investments available for the State’s pension funds, no actual social impact from the proposed new rules will occur.

#### Economic Impact

The proposed new rules will have no direct economic impact, but will facilitate investment diversification which should provide a reduction of total portfolio risk for the State’s pension funds while offering opportunity for improved rates of return over time. Better returns would favorably affect the level of State and municipal contributions over the long term.

#### Federal Standards Statement

A Federal standards analysis is not required because the investment policy rules of the Division of Investment are under the auspices of the State Investment Council, and are not subject to any Federal requirements or standards.

#### Jobs Impact

The State Investment Council and the Division of Investment do not believe that any jobs will be lost by virtue of these proposed new rules. Rather, the expectation is that there will be a creation of jobs within the Division of Investment to assist with the implementation and monitoring of an alternative investment program.

#### Agriculture Industry Impact

The proposed new rules shall have no impact on the agriculture industry.

#### Regulatory Flexibility Statement

A regulatory flexibility analysis is not required, since the proposed new rules impose no requirements on small businesses as the term is defined in N.J.S.A. 52:14B-16 et seq., but regulate only the Director of the Division of Investment.

#### Smart Growth Impact

The proposed new rules are not anticipated to have an impact on the achievement of smart growth and implementation of the State Development and Redevelopment Plan.

Full text of the proposed new rules follows:

## SUBCHAPTER 69. COMMON PENSION FUND E

### 17:16-69.1 Definition

(a) Pursuant to P.L. 1970, c. 270, there is hereby created in the Division of Investment, Department of the Treasury, a common trust fund, to be known as Common Pension Fund E. The following participating funds may invest in said Common Pension Fund E:

1. Police and Firemen's Retirement System;
2. Public Employees' Retirement System;
3. State Police Retirement System;
4. Teachers' Pension and Annuity Fund; and
5. Judicial Retirement System of New Jersey.

### 17:16-69.2 Permissible investments

The Common Pension Fund E shall be a fund created for the purpose of investing in alternative investments which are approved for investment under N.J.A.C. 17:16-71, 90, and 100, and in the State of New Jersey Cash Management Fund. Said common fund shall be composed of units of ownership of unlimited quantity. All units of ownership shall be represented by a certificate prepared by and issued by the Director of the Division of Investment. Each such certificate may represent one or more units of ownership. All units of ownership shall be purchased by cash payments or in kind. All units shall be purchased by the participating fund for the principal valuation price determined by these rules. At the outset of said common fund, all initial purchases shall be made for a principal valuation price of \$1,000 per unit.

### 17:16-69.3 Certificates of ownership

(a) All certificates of ownership of units shall contain the following information:

1. The number of units purchased;
2. The purchaser;
3. The aggregate principal valuation price for the number of units purchased;
4. The date of purchase;
5. The serial number of the certificate; and
6. The principal valuation price per unit purchased.

#### 17:16-69.4 Units of participation

Each unit of participation shall represent an equal beneficial interest in the fund and no unit shall have priority or preference over any other.

#### 17:16-69.5 Valuation

Upon each valuation date, as defined in N.J.A.C. 17:16-69.6, there shall be a valuation for every investment in the common fund in the method provided for in this subchapter. The valuation shall be for the principal value per outstanding unit and the income value per outstanding unit.

#### 17:16-69.6 Date of valuation

The valuation shall be determined at the opening of business of the first business day of each month at the discretion of the Director but in any event such valuation shall be determined no less frequently than once per quarter. The valuation shall be based on market prices and accruals as of the close of the previous day, in every case converted into United States dollars as provided in N.J.A.C. 17:16-69.7.

#### 17:16-69.7 Method of valuation

(a) The Director of the Division of Investment shall use the following method of valuation for investments:

1. Where there has been an independent third party valuation, the valuation established by the independent third party may be used; or
2. The asset class will be valued using valuation criteria as approved by the Director of the Division of Investment.

(b) An investment purchased and awaiting payment against delivery shall be included for valuation purposes as a security and the cost thereof recorded as an account payable.

(c) An investment sold but not delivered pending receipt of proceeds shall be valued at the net sales price.

(d) For the purposes of valuation of an investment, with the exception of investments sold but not delivered, it shall not be necessary to deduct from the value ascertained by this section, brokers' commission or other expenses which would be incurred on a sale thereof.

(e) For the purposes of valuing securities, all values determined under this section shall be converted into United States dollars at rates shown in the Wall Street Journal on the valuation date, or those established by a recognized pricing service.

17:16-69.8 Valuation of units

(a) The following method shall be used in determining the principal value per unit:

1. To the valuation of investments determined as provided in N.J.A.C. 17:16-69.7, there shall be added:
  - i. Uninvested cash principal;
  - ii. The value of any rights, warrants, distributions or other options which may have been declared but not received as of the valuation date, valued in accordance with the method of valuation provided in N.J.A.C. 17:16-69.7;
  - iii. Such portion as shall constitute principal of any extraordinary or liquidating dividend or distributions which may have been declared but which is unpaid as of the valuation date, valued in accordance with the method of valuation provided in N.J.A.C. 17:16-69.7; and
  - iv. Temporary investments which shall be valued at cost. The yield on these temporary investments shall not be accrued, but shall be included in income monthly as paid.
2. There shall be deducted from the sum ascertained under (a) 1 above all expenses chargeable to principal due or accrued. The net principal value thus determined shall be divided by the number of existing units in order to ascertain the principal value of each unit.

(b) All valuations established for items (a) 1i through iv above shall be converted into United States dollars at rates shown in the Wall Street Journal on the valuation date, or those established by a recognized pricing service.

17:16-69.9 Admission date

(a) No admission to or withdrawal from the common fund shall be permitted except on the basis of the principal unit value determined as described in N.J.A.C. 17:16-69.8 and no participation shall be admitted to or withdrawn from the common fund except on a valuation date or within 15 days thereafter; however, in the event that an admission or withdrawal occurs within the 15-day period aforementioned, it shall be based upon the principal value as of the last valuation date preceding said admission or withdrawal.

(b) All admissions or withdrawals shall be made by cash payments or in kind. The price for purchasing units, except for original units issued by the common fund, shall be the principal valuation per unit as determined on each valuation date pursuant to N.J.A.C. 17:16-69.8. Dividends, distributions and interest earned shall be retained within the common fund, but may be distributed in whole or in part to the participatory pension funds, at the direction of the State Investment Council.

17:16-69.10 Amendments

(a) These rules may be amended from time to time by regulation of the State Investment Council.

(b) Any amendment adopted by the State Investment Council shall be binding upon all participating trusts and beneficiaries thereof.

(c) An amendment shall become effective on the date the adoption notice is published in the New Jersey Register. The State Investment Council may, at its discretion, postpone the effectiveness of any amendment by including an operative date in the adoption notice.

17:16-69.11 Distribution of realized appreciation

(a) Subsequent to the receipt of audited financial statements for the prior fiscal year, the State Investment Council may consider the realized appreciation in the common fund per unit. The Council may, in its sole discretion, choose any or all of the following options:



1. Declare as income to the participating funds such percentage of said realized appreciation of principal as it may deem prudent. When such declaration is made, the percentage of such appreciation of principal declared to be income shall be deducted from the total principal in the common fund and added to income in the common fund prior to the next regular monthly valuation. Following such declaration, the amount declared as income shall be treated and distributed as income to the participating funds monthly or quarterly in cash and/or units;
2. Declare as capital gains to the participating funds such percentage of said realized appreciation of principal as it may deem prudent. When such declaration is made, the percentage of such appreciation of principal declared shall be deducted from the total principal in the common fund and distributed monthly or quarterly in cash and/or units; and/or
3. Retain any or all realized appreciation for future investments within the common fund.

#### 17:16-69.12 Limitations

(a) The Common Pension Fund E shall be permitted to invest in the Cash Management Fund and in such investments subject to the limitations and conditions contained in the rules of the State Investment Council, particularly N.J.A.C. 17:16-71, 90 and 100, except for the condition as to classification of funds contained in N.J.A.C. 17:16-3. For all investments made in Common Pension Fund E, the following shall occur:

1. The Director shall provide the Investment Policy Committee of the State Investment Council (Investment Committee) with the requested due diligence information for all investments recommended by the Division and a formal written due diligence report for each such investment. Due diligence information shall include but not be limited to, in all cases, information demonstrating that the investment satisfies the limitations and conditions contained in the rules of the State Investment Council (N.J.A.C. 17:16-71, 90 and 100), and a written disclosure submitted by the asset manager summarizing any and all compensation arrangements with consultants and intermediaries, whether direct or indirect, in connection with the proposed investment.

2. On investments of \$50 million or more, prior to any binding commitment, the Investment Committee shall provide a report to the State Investment Council, which report shall include a written due diligence report by the Director. On a timely basis after receipt of such report, the Council may adopt or otherwise act upon the report.
3. On investments of less than \$50 million, the Director shall provide an informational due diligence report to the State Investment Council of every investment made, which shall be provided on a regular basis subsequent to the date such investment has been made.
4. In any given calendar year, and at any point within such year, at least 80 percent of the number of investments which are approved and 80 percent of the dollar amount of total investment commitments must be eligible for a report by the Investment Committee to the State Investment Council. For investments under \$50 million, so long as such investments constitute no more than 20 percent of the number of investments approved and 20 percent of the total investment dollars committed, the Investment Committee will not issue a report to the Council. Once the Division has exceeded its 20 percent "exemption" in any given year, all proposed investments will be subject to the Investment Committee providing a report to the State Investment Council until the number and dollar value of "exempt" investment again falls below the 20 percent threshold.

(b) After the Director has made binding commitments aggregating an amount of two billion dollars (\$2 billion), not more than five percent of the market value of Common Pension Fund E may be committed to any one partnership or investment, without the prior written approval of the State Investment Council.

(c) The Common Pension Fund E shall not own more than 25 percent of any individual investment. The investments in Common Pension Fund E cannot comprise more than 20 percent of any one investment manager's total assets.

(d) Not more than 13 percent of the market value of the assets of any pension and annuity group fund shall be represented by the market value of investments as permitted by N.J.A.C. 17:16-71, 90 and 100, whether held directly by such pension fund or through Common Pension Fund E. If the market value exceeds 13 percent, then the State Investment Council shall be notified at a regularly scheduled meeting of the Council. The Division may be granted a six-month period of grace to reduce the level of participation of the fund below the 13 percent level, except that the period of grace may be extended for additional four-month periods with the approval of the State Investment Council.

17:16-69.13 Liquidation

(a) The Director, Division of Investment, subject to the approval of the State Investment Council and the State Treasurer, may, upon two months' notice, initiate the liquidation of the aforementioned common fund.

(b) In the event of such liquidation, the owners of the units shall share proportionately, according to units owned, in each investment held by the common fund.

(c) When such proportionate distribution is impracticable in the judgment of the Director, he or she may instead distribute on liquidation, cash or temporary investments held by the common fund.

(d) Distribution upon liquidation shall occur within five days after a valuation date and shall be based upon the principal value per unit determined upon such valuation date.

(e) No liquidation will be effectuated without the approval by the State Investment Council of a plan of distribution of the assets of the common fund.